

CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK (I-BANK)

STAFF REPORT

ISSUE: Staff requests the authority to amend the special counsel contract between the I-Bank and Stradling Yocca Carlson & Rauth to increase the maximum amount of that contract from \$50,000 to \$130,000.

BACKGROUND INFORMATION:

The I-Bank serves as issuer and lender for a highly diverse and technically complex universe of loans, obligations and conduit bonds, and must comply with state statutory and constitutional requirements as well as federal securities law and IRS requirements. In order to ensure compliance with these various laws, the I-Bank has historically used the services of outside special counsel.¹ On July 25, 2006, the Board of Directors of the I-Bank appointed three bond counsel firms² to act as special counsel to the I-Bank, Orrick, Herrington & Sutcliffe, Stradling Yocca Carlson & Rauth, and Hawkins Delafield & Wood LLP. The Board authorized the execution of contracts with those firms in an aggregate amount of not to exceed \$190,000.

The I-Bank subsequently entered into contracts with each of these firms, each with a term of October 1, 2006 through September 30, 2009.³ The contract with Stradling Yocca Carlson & Rauth is in the stated amount of \$50,000. Stradling is a California firm with a strong practice in public finance. Staff has been very pleased with the expertise of the various Stradling attorneys who have provided services to the I-Bank.

NEED FOR INCREASE

Historically the I-Bank has not used its special counsel contracts for issuer counsel services in conduit bond financings. Those services are routinely provided to the I-Bank by in-house counsel, and I-Bank legal and other costs are covered by the bond issuance and application fees paid to the I-Bank by its conduit bond borrowers.

However, during the period between the departure of the I-Bank's prior General Counsel and the arrival of its current General Counsel, a period of approximately two months, I-Bank staff obtained issuer's counsel services from Stradling in order to avoid delays in pending conduit bond transactions. Consistent with the I-Bank's standard business practice of covering I-Bank costs (including in-house issuer counsel costs)

¹ The I-Bank Board approved the engagement of Orrick, Herrington & Sutcliffe LLC ("Orrick") as special counsel in July 1999. In March 2002, the Board approved use of Stradling, Yocca, Carlson and Rauth ("Stradling") as special counsel when Orrick had a conflict. On September 16, 2003, the Board approved special counsel contracts with four firms: Orrick, Stradling, Fulbright & Jaworski L.L.P. and Nossaman, Guthner, Knox & Elliott, LLP.

² Each firm was on the then-current Bond Counsel Pool List maintained by the State Treasurer's Office, and is on the most current list.

³ The initial amount of the contract with Orrick, Herrington & Sutcliffe was \$90,000, and as of the date of this report, the amount remaining is approximately \$60,000. The initial amount of the contract with Hawkins, Delafield & Wood LLP was \$50,000, all of which remains available.

with bond issuance and application fees, borrowers that happened to have transactions during this period were not asked to reimburse the I-Bank for these outside issuer counsel costs.

To date, Stradling has provided issuer counsel services as follows:

- Issuers' counsel service for the approximately \$40 million in refunding bonds issued to refinance the American National Red Cross's blood center in Pomona. For these services Stradling has been compensated \$15,870.
- Issuer's counsel services for the Asian Art Museum refinancing. This transaction has not yet closed due to the current market turmoil. I-Bank staff has terminated Stradling's services on this transaction, and the new I-Bank General Counsel will represent the I-Bank in this transaction when it returns to the market. Stradling has invoiced the I-Bank in the amount of \$13,340.
- Issuer's counsel services for six series of bonds, in the aggregate amount of \$403,500,000 to be exchanged for bonds issued by the I-Bank in 2005 to refinance Pacific, Gas and Electric ("PG&E") projects. These transactions involved a very unusual bond exchange process, new to the I-Bank and to Stradling, and previously used only in one series of transactions by PG&E. These exchange transactions required first-time analysis by the I-Bank and Stradling. Due to the unique nature of the PG&E transactions, special counsel service costs were extremely difficult to estimate. To date Stradling has billed the I-Bank \$61,981 for their services on these six PG&E series. A portion of this invoice in the amount of \$34,130, has been approved by the I-Bank for payment under the existing contract.⁴

In addition to issuer's counsel services, Stradling has provided tax counsel services in relation to an audit notice received from the Internal Revenue Service (IRS). On January 27, 2009, the I-Bank received a notice from the IRS that it was performing a routine examination of an I-Bank industrial development bond transaction from 2004 which financed costs of the Elite Leather Company, Inc. project. Stradling has provided tax counsel to the I-Bank in all prior IRS audits of I-Bank transactions and is in a unique position to provide these services more efficiently than the other counsel with whom the I-Bank has existing contracts. Conduit bond borrowers such as Elite Leather Company, Inc. are required by contract to reimburse the I-Bank for the I-Bank's extraordinary costs such as the defense of an IRS audit and to indemnify the I-Bank for all costs incurred in responding to these audits. However, to date, Elite Leather Company, Inc. has been unwilling to enter into the necessary reimbursement agreement with Stradling for payment of these services. Though it is anticipated that Elite Leather Company, Inc.

⁴ One additional series of PG&E exchange bonds authorized by the Board remains to be issued. The legal issues involved in the PG&E exchange bonds are complex, and Stradling is uniquely qualified to represent the I-Bank as a result of its services in relation to the issuance of six series of exchange bonds. The I-Bank's expenses incurred in relation to the issuance of the prior six series of exchange bonds is believed to have exceeded the \$66,000 in fees received from PG&E for the issuance of all seven series of exchange bonds (I-Bank's counsel costs alone were \$61,981). For these reasons, the I-Bank has asked PG&E, and PG&E has agreed to reimburse the I-Bank's issuer's counsel costs for this one remaining series of exchange bonds by paying Stradling for these costs directly. These additional issuer's counsel costs will not be covered by this contract augmentation

will eventually honor its obligations to the I-Bank, in an abundance of caution, I-Bank staff is proposing the unusual step of adding the estimated tax counsel costs for the defense of this audit to this contract augmentation. It is difficult to estimate the amount that will be necessary to cover the costs of these services at this early stage of the audit, but the amount is not expected to exceed \$30,000.

Total contract costs are now known or can be reasonably anticipated through the term of the contract, which is September 30, 2009. For this reason, staff is recommending that the Stradling contract be increased by \$80,000 from \$50,000 to \$130,000 to cover costs for special counsel services performed or anticipated to be performed through the term of the contract as shown below:

Original Contract Amount	\$	50,000
Costs for Special Counsel Services Performed:		
• American National Red Cross	\$	15,870
• Asian Art Museum	\$	13,340
• PG&E	\$	61,981
Anticipated Special Counsel Service Costs:		
• Audit Services	\$	30,000
• Amount For Uncertainties	\$	8,809
Total Costs Performed and Anticipated	\$	130,000
Requested Contract Augmentation	\$	80,000
Proposed Revised Contract Amount	\$	130,000

Staff is not recommending any other modifications to the Stradling contract.

RECOMMENDATION: Staff recommends approval of Resolution 09-04 authorizing an amendment to the I-Bank's special counsel contract with Stradling Yocca Carlson & Rauth to increase the total amount of the contract authority to \$130,000.